# No. 8606

IN THE

# United States Circuit Court of Appeals

## For the Ninth Circuit

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| COMMISSIONER OF INTERNAL REVENUE, *Petitioner,* | |
| vs. | |
| JOHN FRANCIS NEYLAN, *Respondent.* | |

On Petition for Review of Decision of the United States Board of Tax Appeals.

## BRIEF FOR RESPONDENT.


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## BRIEF FOR RESPONDENT.

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### OPINION BELOW.

The opinion of the United States Board of Tax Appeals is unreported. It appears in the Record herein at pages 14-16. The decision of the Board was in favor of the respondent herein.

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### QUESTION PRESENTED.

Where the taxpayer in 1931 sold at a loss shares of stock which had been held by him for more than two years, and within less than thirty days thereafter repurchased an identical number of shares of the same stocks, and on the same day of such repurchase sold all of the shares, was he entitled to claim his actual loss as a

deduction from his income for the year 1931, or was he restricted to a deduction of but 12½% of his actual loss, as a "capital" loss.

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## STATUTES INVOLVED.

The Statutes, Regulations, Committee Reports, etc., involved herein will be found in the Appendix infra, pages 25-35.

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## STATEMENT.

We do not controvert petitioner's statement of the case. The facts were stipulated to. (R. 25-29.) For convenience, however, we repeat the essential facts.

In 1929 the respondent-taxpayer purchased certain stocks; in 1931 and more than two years thereafter, these stocks were sold.

The next day the same number of shares of the same stocks were purchased by respondent and later on the same day, were sold.

These transactions resulted in an actual loss to the taxpayer of $46,392.79. (R. 28.)

The respondent reported the loss of $46,392.79 as an ordinary loss in his 1931 return.

The Commissioner admits an actual out-of-pocket loss in the sum of $46,392.79, but contends that the respondent is entitled to but 12½% thereof as a "capital" loss; we contend on the other hand, that under the language of the applicable Statute, and under the ruling of the Commis-

sioner in effect at the time (I. T. 2443, infra p. 28) the entire loss is deductible as an "ordinary" loss.

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## SUMMARY OF ARGUMENT.

1. The respondent in claiming his loss as an ordinary loss, rather than reporting it as a capital loss, which was but 12½% of the actual loss, adopted the administrative practice which had been followed for years theretofore, as disclosed by a ruling of the Bureau of Internal Revenue.

This rule was justified as there was no correlation between the "wash sale" and the "capital gain and loss" provisions of the 1928 Act, or previous Acts.

2. *Helvering v. The New York Trust Co.*, 292 U. S. 455 (decided in May, 1934), relied upon by the Commissioner as justifying a departure from the previous administrative practice, is not in point.

*McFeely v. Commissioner*, 296 U. S. 102, shows that the decision in the *New York Trust Co.* case was based upon the peculiar circumstances of the latter case. The *McFeely* case further shows the disposition of the Supreme Court not to extend the rule of the *New York Trust Co.* case beyond its own particular facts.

3. Cases recently decided show that the original ruling of the Bureau of Internal Revenue, treating a loss of this character as an ordinary loss rather than as a capital loss, was correct.

4. The House and Senate Committee Reports on proposed changes in the 1932 Revenue Act show the procedure

adopted by the taxpayer herein was in accordance with the provisions of the 1928 Act, and that in order to change the prevailing rule, the 1932 Act had to be changed.

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## ARGUMENT.

### 1. THE TAXPAYER HEREIN FOLLOWED THE ADMINISTRATIVE PRACTICE PREVAILING IN 1931 AND PRIOR THERETO. THERE IS NO CORRELATION BETWEEN THE WASH SALE PROVISIONS AND THE CAPITAL GAIN AND LOSS PROVISIONS OF THE 1928 REVENUE ACT, OR PREVIOUS ACTS.

The respondent herein purchased certain stocks in 1929. More than two years later, in 1931, these stocks were sold; thereafter, and within thirty days from these sales, the respondent purchased the same number of shares of the same stocks. By reason of these repurchases, the taxpayer was unable to claim his loss occasioned by the original sales. (Section 118, Revenue Act of 1928, infra p. 27.) But the respondent on the same day of these latter purchases, sold the stocks so purchased. It is admitted that by reason of these transactions, the taxpayer suffered an actual out-of-pocket loss of $46,392.79. (R. 28.)

The Commissioner contends that by reason of the provisions of Section 113 (a) (11), of the 1928 Act (infra p. 26), which provides that the *basis* of stock acquired on the second purchase shall be the basis of the stock disposed of, the two holdings should also be treated as one, and added together, for the purpose of determining the *period* for which the stock shall be deemed to have been held in applying the capital assets provision of the Statute.

(Section 101 (c) (8) of the Revenue Act of 1928, infra p. 26.) (See Petitioner's Op. Br. p. 4.)

But the Commissioner completely ignores the fact that the 1928 Revenue Act specifically provides for treating the two holdings as one, for the purpose of determining the *base,* but is silent as to a similar treatment of the two holdings for the purpose of determining the *period,* which in turn determines the *rate.*

Section 118 of the 1928 Act provides that where a loss is claimed on the sale of stock, if within thirty days before or after the sale, the taxpayer has bought, or contracted to buy, substantially identical stock, the loss on that particular sale shall not be allowed.

Section 113 (a) (11) says that where substantially identical stock is acquired in place of the stock sold and in respect to which the loss is not allowable under Section 118, "the basis, in the case of property so acquired, shall be the basis in the case of stock or securities so sold or disposed of". (There are certain exceptions which are not applicable here.)

In other words, for the purpose of determining the *basis,* these two provisions of the Statute *must* be read together, simply because one section specifically refers to the other.

Section 101 (c) (2) of the 1928 Act (infra p. 25), says a capital loss means a deductible loss resulting from the sale of capital assets. A capital asset is defined in Section 101 (c) (8) (infra p. 26) as property held for more than two years. Admittedly the stocks sold on the final transaction were not held for two years, in fact they were sold on the same day as the purchases.

It would have been perfectly simple for Congress to have provided that in the event of a sale, a repurchase and a final sale, such as occurred here, the two holdings should be tacked together for the purpose of determining the rate. In fact, this in effect, was what was done in the 1932 Act. (Revenue Act of 1932, Section 101 (c) (8) (D), infra p. 27.)

The taxpayer in claiming the loss as an ordinary loss, was simply following the ruling of the Income Tax Unit of the Bureau of Internal Revenue as published in Cumulative Bulletin VII-2 (July-December 1928) p. 127, being I. T. 2443. (Infra p. 28.)

The administrative practice whereby a loss of the character involved herein was treated as an ordinary loss and not as a capital loss, was in effect for years prior to the filing of respondent's return for the year 1931, and remained in effect until the latter part of 1934. This was pointed out by the Board of Tax Appeals in the case of *Howard Heinz,* 34 B. T. A. 885, at 890-893. (This case is now on appeal to the Circuit Court of Appeals for the Third Circuit.) The *Heinz* case is on all fours with the instant case and was decided in favor of the taxpayer.

Referring to the administrative practice as evidenced by I. T. 2443, pettioner in his opening brief (p. 12) says:

> "We submit that there is nothing of any binding character in the interpretation of the statutory provisions given by the Commissioner in the earlier rulings. See *Helvering v. N. Y. Trust Co.,* supra, p. 468. The cautionary notice published in the bulletins in which those rulings appear clearly points out that they do not commit the Treasury Department to any interpretation of the law."

We do not contend, of course, that the Commissioner can issue a ruling which will foreclose the Courts from the judicial construction of a statute. We do contend, however, that any administrative practice followed by Government offices and officials over a period of years, is not to be lightly disregarded.

Commissioner's counsel seeks to escape the force of this long-established and unvarying practice, by reference to the "cautionary notice published in the Bulletins in which those rulings appear". (Petitioner's Op. Br. p. 13.)

This "cautionary notice" is found on the cover of C. B. VII-2, in which I. T. 2443 is found at page 127. It reads as follows:

> "SPECIAL ATTENTION is directed to the cautionary notice on this page that published rulings of the Bureau do not have the force and effect of Treasury Decisions *and that they are applicable only to facts presented in the published case.*" (Italics supplied.)

This is amplified as follows:

> "The rulings reported in the Internal Revenue Bulletin are for the information of taxpayers and their counsel as showing the trend of official opinion in the administration of the Bureau of Internal Revenue; the rulings other than Treasury Decisions have none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of the law which has not been formally approved and promulgated by the Secretary of the Treasury. Each ruling embodies the administrative application of the law and Treasury Decisions to the entire state of facts upon which a particular case rests. *It is especially to be noted that the same result will not necessarily be reached in another case unless all the mate-*

> *rial facts are identical with those of the reported case.* As it is not always feasible to publish a complete statement of the facts underlying each ruling, there can be no assurance that any new case is identical with the reported case. * * *." (Italics supplied.)

Of course, it will not be disputed that the situation as disclosed in the instant case comes directly within the language of I. T. 2443.

The rule as announced in I. T. 2443, was and is amply justified, in view of the fact that there was no correlation between the wash sale provision and the capital gain and loss provision of the several Revenue Acts containing these provisions.

In connection therewith, the Board in the *Heinz* case stated (see 34 B. T. A. 889, note 5):

> "In both the Gregg 'Statement of the Changes Made in the Revenue Act of 1921 by H. R. 6715 and the reasons therefor,' and the Committee Reports, it is apparent that no thought was given to correlating the wash sale provision with the capital gain and loss provision. This is likewise true of the Committee reports upon the revenue bills of 1926 and 1928."

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2. THE DECISION IN HELVERING v. NEW YORK TRUST CO., DID NOT JUSTIFY THE COMMISSIONER IN DEPARTING FROM PREVIOUS ADMINISTRATIVE PRACTICE. McFEELY v. COMMISSIONER SHOWS THE SUPREME COURT REFUSED TO EXTEND THE DOCTRINE OF THE NEW YORK TRUST CO., CASE.

The Commissioner applied the rule as set forth in I. T. 2443, which rule the respondent followed in making his 1931 return, until the latter part of 1934, when in I. T.

2832, C. B. XIII-2, p. 201, infra p. 30, there was a "modification" of I. T. 2443 and it was ruled that the two year period of the capital assets section of the Revenue Act of 1928, and prior Acts, "runs from the date of acquisition of the original securities and not from the date of repurchase". (This "modification" is pointed out in the Board's opinion in the *Heinz* case, 34 B. T. A. at p. 893.)

In support of this entirely new ruling, the statement is made "See generally the reasoning contained in the decision of the U. S. Supreme Court in *Helvering v. New York Trust Co., Trustee,* 292 U. S. 455."

The essential facts in the *New York Trust Co.* case are briefly as follows:

A donor in 1921 conveyed certain securities to a trustee for the benefit of his, the donor's, son. The transfer was held to be a gift. The trustee sold the securities in 1922 (less than two years after the conveyance to the trustee). This resulted in a large profit based on the *cost* to the donor in 1906, which was the donor's *basis.*

The 1921 Revenue Act, which was applicable, provided that in the case of a *gift* of property, upon a sale of such property "the basis shall be the same as that which it would have had in the hands of the donor".

The 1921 Act also provided that property held for more than two years constituted capital assets and that the gain resulting from a sale of capital assets should be taxed at but 12½% (at option of the taxpayer) instead of at the ordinary rates.

The sale in question was made by the trustee *less* than two years after the conveyance to the trustee. (The con-

veyance took place in 1921; the sale took place in 1922.) As a result, the Commissioner contended that the property sold did not constitute "capital assets" and that the large gain resulting should be taxed at the ordinary rates.

The trustee in reporting the gain was *required* by law to use the donor's basis. This was the cost to the donor in 1906. The cost to the donor was roughly \$141,000.00; the value at the time of the creation of the trust in 1921 was about \$577,000.00; the sale in 1922 realized slightly over \$603,000.00.

As a result there would have been an enormous tax on the large gain represented by the difference between the cost to the donor and the 1922 sale price, if the gain had been taxed at the ordinary rates. As pointed out, the trustee was *required* to take the *donor's* basis.

The question presented to the Supreme Court was whether or not on these facts the period of holding by the donor could be tacked onto the holding by the trustee for the purpose of bringing the holding within the capital asset provision of the 1921 Act. (Property held more than two years.)

The Court said (292 U. S. 467):

> "Here the taxable gain was ascertained by putting together the periods in which the shares were held by trustor and trustee respectively. The taxable gain was the same as if the former held continuously from the time of purchase in 1906 until the sale in 1922. But to ascertain the applicable rate the Commissioner broke the continuity. If the trustor had held until the sale, the 12½ per cent rate would have been applicable and the tax would have been substantially less than one-fourth of the amount assessed against the trustee

> who, for the purpose of calculating the gain, was substituted for the trustor."
>
> * * * * * * *
>
> "There is no ground for discrimination such as that to which the trustee was subjected. It is to be inferred that Congress did not intend penalization of that sort."

It is submitted that the decision in this case is based upon its own peculiar facts and is not to be extended to a case where the facts are different, and is not controlling here.

The Commissioner in the *Heinz* case, supra, urged the *New York Trust Co.* case upon the Board as controlling. The Board rejected it and held it not applicable. See the Board's discussion of the *New York Trust Co.* case in 34 B. T. A. at 893, et seq.

(May we at this time point out an unintentional error, in referring to the *N. Y. Trust Co.* case, in Petitioner's Opening Brief, p. 10, which might prove confusing. The brief reads:

> "We submit that that change does not diminish the soundness or force of the principle of conformity which was adopted both by *this* Court and by the Supreme Court in the N. Y. Trust Co. case." (Italics supplied.)

In referring to "this Court", the writer of the brief is referring to the Circuit Court of Appeals for the *Ninth* Circuit. This is an error; the *New York Trust Co.* case was decided by the *Second* Circuit.)

*McFeely v. Commissioner,* 296 U. S. 102, 80 L. Ed. 83:

As indicating the intention of the Supreme Court to confine the rule announced in the *New York Trust Co.* case

to its own peculiar facts, see *McFeely v. Commissioner*, 296 U. S. 102. At page 105 the Court says:

> "These cases were brought here on writs of certiorari to resolve a conflict between Circuits with respect to the application of Sec. 101 of the Revenue Act of (May 29) 1928, which permits taxpayers, at their option, to pay at the rate of twelve and one-half per cent on capital net gains. Subsection (c) (8), so far as material, is: '"Capital assets" means property held by the taxpayer for more than two years * * *' Whether property acquired from a decedent through intestacy, or a general bequest, is, within the meaning of the clause, held by the taxpayer from the date of the decedent's death or from the date of distribution, is the matter in dispute."

And at page 110:

> "Counsel urge that Helvering v. New York Trust Co., 292 U. S. 455, 78 L. ed. 1361, 54 S. Ct. 806, supra, requires us to construe Sec. 101 (c) (8) as fixing the same date for the beginning of the holding period as Sec. 113 (a) (5) sets for determining the basis. We think, however, that the case is not authority here. The Act of 1921 exhibited an inconsistency in that while a donee was not permitted to tack his tenure to that of his donor, he was required to use his donor's basis. This inconsistency flowed from a literal reading of the separate sections dealing with these two subjects. Such a result the court held would run counter to the very policy and purpose of the capital gains rate reduction, which was to encourage sales of capital assets, and would penalize the taxpayer making such sales. The departure from the strict terms of the act was justified in order to secure him the benefit intended to be conferred. The court was care-

> ful to say 'The rule that where a statute contains no ambiguity, it must be taken literally and given effect according to its language is a sound one * * *' That rule was held inapplicable for the reasons stated.
>
> Here the rule obtains that a taxing statute, if of doubtful intent, should be construed favorably to the taxpayer. To depart from the literal meaning of Sec. 101 (c) (8) would be to penalize the taxpayer by lengthening the period during which the capital asset must be held in what is really a single ownership to obtain the advantage of the reduced tax. Under these circumstances we ought not to depart from the plain meaning of the section in an effort to bring about a uniformity which it is claimed Congress intended but failed to express."

The Supreme Court in deciding the *McFeely* case, supra, also decided four additional cases involving the same point. Amongst them was *Isabel K. Dibblee v. Commissioner,* on writ of certiorari from the United States Circuit Court of Appeals for the *Ninth* Circuit, opinion reported in 75 Fed. (2d) 617. The decision of the Ninth Circuit was reversed.

Reverting to the *New York Trust Co.* case, may we point out that the decision in the Court below was by the Circuit Court of Appeals for the *Second* Circuit (68 Fed. (2d) 19), which decision was affirmed by the Supreme Court.

It is interesting to note that the following cases involving the precise point involved in the instant case, were decided by the Board of Tax Appeals:

*Guy Cary v. Commissioner,* unreported; Memorandum Opinion—August 18, 1936;

*Estate of Clara S. Peck, et al. v. Commissioner,* unreported; Memorandum Opinion—August 18, 1936,

and were later appealed to the *Second* Circuit.

Government briefs filed in the *Cary* and *Peck* cases (in the Circuit Court) show the *New York Trust Co.* case was urged upon the Court as controlling.

Despite the fact that the Second Circuit had decided the *New York Trust Co.* case, which was affirmed by the Supreme Court, the Peck and Cary decisions of the Board of Tax Appeals (in favor of the taxpayer) were affirmed by the Second Circuit, per curiam, and without opinion.

*Commissioner v. Cary,* 91 Fed. (2d) 1009;
*Commissioner v. Peck,* 91 Fed. (2d) 1011.

If the Circuit Court of Appeals for the Second Circuit had felt that the *New York Trust Co.* case was even remotely applicable, we submit that the case would have been distinguished from the *Peck* and *Cary* cases in a written opinion.

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3. **CASES RECENTLY DECIDED SHOW THAT THE ORIGINAL RULING BY THE BUREAU OF INTERNAL REVENUE IN TREATING A LOSS OF THIS CHARACTER AS AN ORDINARY LOSS RATHER THAN AS A CAPITAL LOSS, WAS CORRECT.**

Respondent filed his Income Tax Return for the calendar year 1931 on March 15, 1932. (R. 26.)

At that time no cases had been decided by the Board or the Courts on the point involved herein.

However, there had been published in C. B. VII-2, p. 127, covering the July-December, 1928, period, an Income Tax Unit ruling known as I. T. 2443. (Infra p. 28.)

This ruling has to do with certain sections of the Revenue Act of 1926. It applies, however, to the Revenue Act of 1928, Section 101 (c) (8), infra p. 26; Section 113 (a) (11), infra p. 26; and Section 118, infra p. 27.

We quote from I. T. 2443, as follows:

> "With reference to the application of the capital gain and loss provisions of section 208 of the Revenue Act of 1926, it is noted that although the deduction of any loss is postponed in the case of such 'wash sales' until there is a disposition of the stock with no repurchase within the proscribed period, the stock in the case under consideration was not held for a period of more than two years. *During the period from the date of the 'wash sale' to the date of repurchase the taxpayer did not own or hold any stock. The two-year period in such case, for the purpose of the capital gain and loss provisions of section 208, accordingly runs from the date of the repurchase and not from the date of the original purchase.*" (Italics supplied.)

It is not disputed, of course, that the taxpayer in claiming an ordinary loss (represented by his *actual* loss) rather than a capital loss (represented by but 12½% of his actual loss) was following the rule as laid down by the Commissioner himself.

The rule remained in effect until late in 1934, when it was "modified" by I. T. 2832. See C. B. XIII-2, p. 201 (July-December, 1934, period, infra p. 30.) In announcing this modified ruling, reliance was placed upon the "reason-

ing'' of the United States Supreme Court in the *New York Trust Co.* case, supra.

This Supreme Court case was decided in May, 1934, and has already been discussed, supra.

The precise point involved herein was first decided by the Board of Tax Appeals in the *Heinz* case, 34 B. T. A. 885. We urge this Court to carefully read this opinion, regardless of the outcome of the appeal now pending before the Circuit Court of Appeals for the Third Circuit.

The opinion is well reasoned; it discusses the legislative history of the applicable sections of the Revenue Act of 1928, and prior Acts, and the House and Senate Committee Reports issued in relation thereto; it discusses the administrative practice prevailing for some years, and finally it discusses the Amendment to the Revenue Act of 1932 (Section 101 (c) (8) (D), infra p. 27), whereby the rule which the Commissioner seeks to have applied herein was incorporated in the Statute itself.

Following the *Heinz* case the Board rendered identical decisions in *Guy Cary v. Commissioner,* unreported, Memorandum Opinion, August 18, 1936; *Estate of Clara S. Peck, et al. v. Commissioner,* unreported, Memorandum Opinion, August 18, 1936 (see 34 B. T. A. 1308 and 1314), and *Lewis v. Commissioner,* 34 B. T. A. 996, decided on September 17, 1936.

As we have pointed out, the *Peck* and *Cary* cases were appealed to the Circuit Court of Appeals for the Second Circuit and affirmed without opinions.

> *Commissioner v. Cary,* 91 Fed. (2d) 1009, Decided June 28, 1937;

*Commissioner v. Peck,* 91 Fed. (2d) 1011, Decided June 28, 1937.

The *Lewis* case, supra, is still on appeal to the Circuit Court of Appeals for the Second Circuit.

What is referred to in the Petitioner's Opening Brief as a "similar question" has been decided in favor of the Government in *Augustus v. Moore,* not officially reported, but found in 1937 C. C. H., Federal Tax Service, Vol. IV, par. 9400, decided by the District Court for the Northern District of Ohio, on June 12, 1937.

The opinion as reported in the Commerce Clearing House Service, supra, does not set forth the facts, nor does it refer to the *Heinz* or other cases decided by the Board, nor to the holdings of the Circuit Court of Appeals for the Second Circuit in the *Peck* and *Cary* cases, supra, nor does it make reference to the *New York Trust Co.* case, supra, upon which the Commissioner herein places such great reliance.

**Summary of cases decided.**

The Board of Tax Appeals has held in favor of the taxpayer in the *Heinz, Cary, Peck* and *Lewis* cases, and in the instant case.

The Circuit Court of Appeals for the Second Circuit has held in favor of the taxpayer in the *Peck* and *Cary* cases.

The *Lewis* case, decided in favor of the taxpayer by the Board is still on appeal to the Second Circuit.

The *Heinz* case, decided by the Board in favor of the taxpayer, is now on appeal to the Circuit Court of Appeals for the Third Circuit.

The District Court for the Northern District of Ohio has held in favor of the Government on what is referred to in the Petitioner's Brief herein as a "similar question". This case is now on appeal to the Sixth Circuit.

We submit that the Board decisions and the decisions of the Circuit Court of Appeals for the Second Circuit amply support I. T. 2443, which the taxpayer herein followed in making his return for the year 1931.

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4. **THE HOUSE AND SENATE COMMITTEE REPORTS ON PROPOSED CHANGES IN THE 1932 REVENUE ACT SHOW THE PROCEDURE ADOPTED BY THE TAXPAYER HEREIN WAS IN ACCORDANCE WITH THE PROVISIONS OF THE 1928 ACT, AND THAT IN ORDER TO CHANGE THE PREVAILING RULE, THE 1932 ACT HAD TO BE CHANGED.**

The exact situation dealt with in the instant case was considered by the House Committee on Ways and Means in considering changes in the proposed Revenue Bill of 1932. See this Report, infra, p. 31.

In the Report of the Committee it was pointed out that the 12½% limitation imposed by Section 101 (b) of the 1928 Act was easily avoided through the procedure adopted by the taxpayer herein. This procedure, let it be again stated, *was in accordance with the Commissioner's own ruling* in effect at the time.

The example stated by the Ways and Means Committee in its report was exactly the procedure adopted by the taxpayer herein.

The Senate Report is to the same effect (this Report is printed in full, infra p. 34). The statement in the Commissioner's Opening Brief (p. 15) and in the dis-

senting opinion of the Board in the *Heinz* case (34 B. T. A., 901) that the Senate Committee described the addition of subparagraph (D) to Sec. 101 (c) (8) to the 1932 Act is declaratory of the existing law are *incorrect.*

It was the amendment to Section 118 which the Senate Committee referred to as "declaratory"; and the same language regarding that amendment also appeared in the House Committee Report, as stated in the prevailing opinion of the Board.

The Board of Tax Appeals in the *Heinz* case, supra, says in relation to these reports (34 B. T. A., at 897, et seq.):

> "Meanwhile, the matter had come to the attention of the Congress in its consideration of the Revenue Bill of 1932. In the Report of the House Committee on Ways and Means (No. 708, 72d Cong., 1st sess., p. 16), the operation of the existing law under the Revenue Act of 1928 was fully recognized and a deliberate change was proposed. The Committee Report on this subject is quoted in full in the margin.
>
> The Report of the Senate Committee is also set out in the margin, and we think recognizes, no less than the House Report, the situation which was to be changed. The law was amended in the Revenue Act of 1932, by adding the following paragraph to section 101 (c) (8):
>
> > '(D) In determining the period for which the taxpayer has held stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 118 of this Act or the Revenue Act of 1928, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, there shall be included the period for

which he held the stock or securities the loss from sale or other disposition of which was not deductible.'

There can be no doubt, therefore, that from the time when the 1932 Revenue Act became law the composite loss from the first and second sales was to be treated as a capital loss if the period of the combined tenures of the original and of the newly purchased stock was two years or more. The Commissioner, however, treats paragraph (D), supra, of the 1932 Act as merely a clarifying provision of existing law. This is without foundation. It is a new provision. Congress might indeed have undertaken to make it retroactively effective to cover situations antedating its enactment, but it failed to do so. In the light of its unmistakable knowledge of the operation of the existing law, appearing from its Committee Reports, there can be no doubt that the failure to make the provision retroactive was deliberate. Neither the Commissioner nor the Board has power to change the effect of this deliberate choice of Congress by construing the provision of the 1932 Act as if it had been made retroactive. And this is likewise true of any present attempt by the Commissioner to make his present interpretation of the 1928 Act retroactive."

Petitioner, in his opening brief, page 15, says:

"However, as pointed out in the dissenting opinion in the *Heinz* case (34 B.T.A. 885, 901), the Senate Finance Committee had a different view as to the interpretation of the 1928 Act and as to the effect of adding subparagraph (D) to the 1932 Act. S. Rep. No. 665, 72d Cong., 1st Sess., pp. 22-23. The Senate Committee apparently thought that the new provision in the 1932 Act would be merely declaratory of the existing law—would be merely a clarification and not a change in the law."

But the *prevailing* opinion in the *Heinz* case (p. 898) says:

> "The Report of the Senate Committee is also set out in the margin, and we think recognizes, no less than the House Report, the situation which was to be changed."

It should be remembered that the provisions of the various Revenue Acts postponing the loss where repurchases of the same kind of property are made within thirty days before or after the sale, and restricting the loss to but 12½% of the actual loss if the property sold consists of "capital assets" (property held more than two years), are purely arbitrary. They should be construed strictly against the government.

We contend that the provisions of the 1928 Revenue Act in relation to the above matters are perfectly clear and free from ambiguity, but if it should be thought that the statute is doubtful, still the taxpayer is entitled to a decision in his favor. As was said in *McFeely v. Commissioner,* 296 U. S. 102, at 111:

> "Here the rule obtains that a taxing statute, if of doubtful intent, should be construed favorably to the taxpayer."

It was also argued by petitioner (Opening Brief, p. 8) that the treatment of the two holdings for the purpose of fixing the base requires a similar treatment for the purpose of fixing the rate, *in the interest of harmony and consistency.*

This same argument was used in the *Heinz* case. The Board answered it as follows (34 B. T. A. 896):

"Because of the disallowance of the loss deduction on the wash sale, it is contended that the taxpayer's tenure of the new and entirely distinct property should, despite the intervening lapse, be tacked to the tenure of his old, in order to establish the rate, regardless of the fact that if the result of the original sale had been a gain, his two periods would not have been tacked. Congress may conceivably tack the same taxpayer's tenures of different pieces of property for tax purposes as it does the tenures of the same property held by successive taxpayers, but, in the absence of a clear indication of intention to do so, there must be some logical necessity for adopting a construction contrary to the plain words of the statute. *No such logical compulsion exists here, for the result sought by the Commissioner would lack the very balance and harmony which is said to be its justification.* The wash sale provision and its dependent provision, changing the base of property coming within its terms, is too narrow in its intent and effect to be extended by implication." (Italics supplied.)

The argument was also made in the case of *McFeely v. Commissioner,* supra, but the Supreme Court replied as follows (296 U. S., at p. 111):

"To depart from the literal meaning of Sec. 101 (c) (8) would be to penalize the taxpayer by lengthening the period during which the capital asset must be held in what is really a single ownership to obtain the advantage of the reduced tax. Under these circumstances we ought not to depart from the plain meaning of the section *in an effort to bring about a uniformity which it is claimed Congress intended but failed to express.*" (Italics supplied.)

There is also a very interesting statement along this line by Mr. Justice Roberts, in a *dissenting* opinion in *Helvering v. New York Trust Co.* (See 292 U. S. 455, at 471):

> "Assuming however, for the sake of argument, that there is a logical inconsistency between the prescribed method for arriving at the base and that for ascertaining the rate, it is the province of Congress alone to remove it. There is no abstract justice in any system of taxation. Nothing could involve more dangerous consequences, than that the courts should rewrite plain provisions of a tax act in order to bring them into harmony with a supposed general policy. Such a principle of decision would embark us on a sea of construction whose bounds it is difficult to envisage. Every revenue act embodies policies which conflict to some extent with those elsewhere in the Act evinced. Income tax legislation is a continuous series of corrections and amendments in an effort to make the policy of taxation more congruous.
>
> The very sections extending the relief of a reduced rate on capital gains, teach us how inconsistently the principle has been followed and how impossible and improper it would be for a court to rewrite the sections in an effort to make them logically consistent."

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## CONCLUSION.

We submit the taxpayer properly claimed the loss in question as an ordinary loss rather than as a capital loss.

This was in accordance with the ruling of the Commissioner in effect at the time the return was filed, which rule remained in effect until late in 1934. (I. T. 2443.)

The correctness of the Commissioner's rule has been upheld by the Board of Tax Appeals and by the Circuit Court of Appeals for the Second Circuit.

That the Commissioner had correctly interpreted the law as shown by I. T. 2443 is further evidenced by the House and Senate Reports in connection with the proposed 1932 Revenue Act.

The addition to the 1932 Act (Section 101 (c) (8) (D)) is clearly a change in the law and not merely a clarification thereof.

The Board's decision should be affirmed.

Dated, San Francisco,
January 17, 1938.

Respectfully submitted,

J. PAUL MILLER,
*Attorney for Respondent.*

**(Appendix Follows.)**

# Appendix.

## Appendix

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**Revenue Act of 1928, c. 852, 45 Stat. 791.**

Sec. 101. Capital Net Gains and Losses.

(a) Tax in case of capital net gain.—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be at this amount plus 12½ per centum of the capital net gain.

(b) Tax in case of capital net loss.—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title——

* * * * * * *

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

* * * * * * *

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

Sec. 113. Basis for Determining Gain or Loss.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that——

* * * * * * *

(11) Wash Sales of Stock.—If substantially identical property was acquired after December 31, 1920, in place of stock or securities which were sold or disposed of and in respect of which loss was not allowed as a deduction under section 118 of this Act, or under section 214 (a) (5) or 234 (a) (4) of the Revenue Act of 1921, the Revenue Act of 1924, or the Revenue Act of 1926, the basis in the case of the property so acquired shall be the basis in the case of the stock or

securities so sold or disposed of, except that if the repurchase price was in excess of the sale price such basis shall be increased in the amount of the difference, or if the repurchase price was less than the sale price such basis shall be decreased in the amount of the difference;

* * * * * * *

Sec. 118. Loss on Sale of Stock or Securities.

In the case of any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities where it appears that within thirty days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) or has entered into a contract or option to acquire substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition, no deduction for the loss shall be allowed under section 23 (e) (2) of this title; nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business. If such acquisition or the contract or option to acquire is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed.

**Revenue Act of 1932, c. 209, 47 Stat. 169.**

Sec. 101 (c) (8) (D):

In determining the period for which the taxpayer has held stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under section 118 of this Act

or the Revenue Act of 1928, relating to wash sales) of the loss from the sale or other disposition of substantially identical stock or securities, there shall be included the period for which he held the stock or securities the loss from the sale or other disposition of which was not deductible.

**I. T. 2443 C. B. VII-2, p. 127.**

SECTION 214 (a) 4, 5, 6—DEDUCTIONS ALLOWED INDIVIDUALS: LOSSES.

| | |
|---|---|
| Article 146: Losses from the sale and repurchase of securities. | VII-50-4031 I. T. 2443 |

(Also Section 208, Article 1651.)

REVENUE ACT OF 1926.

In the case of "wash sales" of stock, the deduction of any loss sustained is to be postponed until the stock is disposed of and not repurchased within the proscribed period of time, and it is immaterial whether the adjustment of basis be made on the original basis or on the repurchase price.

The two-year period provided by Section 208 of the Revenue Act of 1926 runs from the date of the repurchase, in the case of "wash sales", and not from the date of the original purchase.

(G. C. M. 1210, C. B. VI-2, 60, amplified.)

Information is desired relative to the interpretation placed on Article 1601 of Regulations 69 and Section 204(a) 11 of the Revenue Act of 1926 pertaining to "wash sales" of stock by General Counsel's Memorandum 1210. Attention is called to the fact that the regulations provide for determining the adjusted basis on which to compute

the gain or loss resulting from the final sale by increasing or decreasing the original basis by the difference between the price at which the "wash sale" was made and the repurchase price whereas the memorandum in question provides that such adjusted basis may be arrived at by increasing the repurchase price by the amount of the indicated loss on the "wash sale".

While the statute and regulations provide that such adjusted basis is to be determined by increasing or decreasing the original basis by the difference between the price at which the "wash sale" is made and the repurchase price, the object or purpose is to postpone the deduction of any loss until the stock is disposed of and not repurchased within the proscribed period of time, and it is therefore immaterial whether the adjustment be made on the original basis or on the repurchase price, as the result is the same in either case. The memorandum in question, by way of summary, merely states that the indicated loss on the "wash sale" may be added to the repurchase price in arriving at such adjusted basis. With reference to the application of the capital gain and loss provisions of Section 208 of the Revenue Act of 1926, it is noted that although the deduction of any loss is postponed in the case of such "wash sales" until there is a disposition of the stock with no repurchase within the proscribed period, the stock in the case under consideration was not held for a period of more than two years. During the period from the date of the "wash sale" to the date of repurchase the taxpayer did not own or hold any stock. The two-year period in such case, for the purpose of the capital gain and loss provisions of Section 208, accordingly runs from

the date of the repurchase and not from the date of the original purchase.

**I. T. 2832 C. B. XIII-2, p. 201.**

SECTION 101. CAPITAL NET GAINS AND LOSSES.

Article 501: Definition and illustration of capital net gain. XIII-49-7164 I. T. 2832

REVENUE ACT OF 1928 and PRIOR REVENUE ACTS.

In the case of "wash sales" the two-year period during which property must be held to constitute "capital assets" within the meaning of Section 101 of the Revenue Act of 1928 and the corresponding provisions of prior Revenue Acts runs from the date of the acquisition of the original securities and not from the date of repurchase.

I. T. 2443 (C. B. VII-2, 127) is modified accordingly.

I. T. 2443 holds in part as follows:

The two-year period provided by Section 208 of the Revenue Act of 1926 runs from the date of the repurchase, in the case of "wash sales", and not from the date of the original purchase.

Under the Revenue Act of 1928 and corresponding provisions of prior Revenue Acts, where securities held for more than two years are sold, substantially identical securities are acquired within a period of 30 days (resulting in a "wash sale" under Section 118 of the Revenue Act of 1928), and a second sale of the securities is made within the two-year period after the repurchase, the two-year period during which the property must be held to constitute "capital assets" within the meaning of Section 101 of the Revenue Act of 1928, and the corresponding pro-

visions of prior Revenue Acts runs from the date of acquisition of the original securities, and not from the date of repurchase. Any loss sustained from the sale of the repurchased securities should be treated as a capital loss. I. T. 2443 is modified accordingly. (See generally the reasoning contained in the decision of the United States Supreme Court in Helvering v. New York Trust Co., Trustee (Conrad Henry Matthiessen), 292 U. S. 455, Ct. D. 840, C. B. XIII-1, 188.)

**Report of the House Committee on Ways and Means No. 708, 72nd Congress, 1st Sess., p. 16 (in relation to changes in the proposed Revenue Bill of 1932).**

Sections 101 (c) (8), 113 (a) (11), and 118.

Wash Sales.

The 12½ per centum limitation imposed by section 101 (b) of the 1928 act upon losses from the sale of property held for more than two years, is easily avoided in the case of stock or securities. A taxpayer, desirous of taking a loss on stock which he has held for more than two years, would sell the stock, "repurchase" it within 30 days, and then sell the repurchased stock. The loss on the first sale (the "wash" sale) would not, by reason of section 118, be allowed as a deduction, but the repurchased stock would have substantially the high basis of the stock sold (under section 113 (a) (11)). Since the repurchased stock would not have been held for more than two years when sold, the loss on its sale would not be a "capital loss" but an "ordinary deduction" allowable without limitation. Thus the taxpayer would end in virtually the same financial position as if he had made an outright sale in the first instance but would escape the

limitation under section 101 (b) which would have applied if he had made an outright sale.

For example, A bought stock in 1927 for $100,000, which stock was worth $50,000 in 1931. In November, 1931, A sold his stock for $50,000 and repurchased identical stock within thirty days for the same amount. By reason of section 118 of the present law, A is denied a deduction for the $50,000 loss, and under section 113 (a) (11) of the present law, his new stock takes $100,000 as its basis. Thereafter, A again sold the repurchased stock for $50,000. A is entitled under the present law to deduct a loss of $50,000 from his gross income and is not subjected to the 12½ per centum limitation to which he would be restricted under section 101 (b) of the present law had he simply sold his original stock.

Such anomalous results are precluded by subparagraph (D) of section 101 (c) (8) of the new bill, which requires the taxpayer to add to the period for which he has held the stock or securities purchased in connection with a "wash" sale, the period for which he had held the stock or securities sold. Under the proposed bill in the above example A would be subject to the 12½ per centum limitation on its loss.

In many cases of "wash" sales the shares disposed of in the "wash" sale have been purchased at different times and at different prices, or the shares repurchased in connection with the sale are subsequently sold at different times and at different prices, or the number of shares repurchased are greater or less than the number of shares sold. In all such cases some allocation as between the shares sold and the shares repurchased is absolutely es-

sential in order to apply the new "tacking" provision included in section 101 (c) (8); and such allocation is, in fact, equally desirable in determining the amount of the loss to be disallowed in the "wash" sale and the basis for computing future gain or loss on the shares repurchased in connection with the "wash" sale. In the prior act it was assumed that such identification or allocation was unnecessary or, if necessary, could readily be made. In the types of cases mentioned above an accurate allocation is often impossible, and resort must be had to some rule of thumb. As it would be impracticable to state in the act a rule of uniform application to all the possible types of cases, it is provided in subsections (b) and (c) of section 118 that such allocation shall be made under rules and regulations to be prescribed by the commissioner. The allocation so made will, of course, be applicable not only for the purpose of section 118 but also for the purpose of sections 101 (c) (8) and 113 (a) (11). In view of this new provision the last sentence of section 118 of the 1928 act has been eliminated.

Section 118 has been amended to show clearly that the wash sale provisions apply to sales and repurchases occurring on the same day; this change is regarded as declaratory of the existing law and is made in the interest of clarity only. The section has also been amended to make it clear that it applies only to cases of the acquisition of substantially identical stock or securities by purchase or through a taxable exchange on which the gain or loss was fully recognized; the result of the amendment is to eliminate any possibility of a conflict between section 113 (a) (11) and other basis provisions of the

law. Other changes in the language of sections 113 (a) (11) and 118 are for clarification only.

**Senate Report No. 665, 72nd Congress, 1st Session (in relation to changes in the proposed Revenue Bill of 1932).**

Sections 101 (c) (8) (D), 113 (a) (11), and 118.

Wash Sales.

Section 101 (c) (8) of the existing law recognizes that in certain cases where the gain or loss basis of old property carries over, in whole or in part, to newly acquired property, the newly acquired property is regarded as taking the place of the old property and the two are regarded as the same property for the purpose of determining the period the property was held. The existing law does not specifically cover the cases of property acquired in connection with a wash sale, although no loss from such sale was recognized under section 118 and the basis of the old property is carried over in whole or in part under section 113 (a) (11) to the new property. Your committee sees no reason why property acquired under these circumstances should not be accorded the same treatment as is accorded in other similar cases. Accordingly, a new subparagraph (D), added to section 101 (c) (8) by the House bill, is concurred in by your committee.

In many cases of "wash" sales the shares disposed of in the "wash" sale have been purchased at different times and at different prices, or the shares repurchased in connection with the sale are subsequently sold at different times and at different prices, or the number of shares repurchased are greater or less than the number of shares sold. In all such cases some allocation as between the shares sold and the shares repurchased is abso-

lutely essential in order to apply the new "tacking" provision included in section 101 (c) (8); and such allocation is, in fact, equally desirable in determining the amount of the loss to be disallowed on the "wash" sale and the basis for computing future gain or loss on the shares repurchased in connection with the "wash" sale. In the prior act it was assumed that such identification or allocation was unnecessary or, if necessary, could readily be made. In the types of cases mentioned above an accurate allocation is often impossible, and resort must be had to some rule of thumb. As it would be impracticable to state in the act a rule of uniform application to all the possible types of cases, it is provided in subsections (b) and (c) of section 118 that such allocation shall be made under rules and regulations to be prescribed by the commissioner. The allocation so made will, of course, be applicable not only for the purpose of section 118 but also for the purposes of section 101 (c) (8) and 113 (a) (11). In view of this new provision the last sentence of section 118 of the 1928 act has been eliminated.

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